

Mr. E. V. Anderson

Ann Otake
Insurance Tax

May 2, 1988

Refer to STOP

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Claim for Refund of Retaliatory Taxes
paid for tax year 1986

Facts

is an insurance company that was domesticated in . . . s retaliatory tax for 1986 was calculated by using . . . as the state of domicile, and . . . was assessed a retaliatory tax of \$844,605.00 in a notice dated . . . In a letter dated . . . asked that the assessment be corrected by reducing it to zero because . . . had redomesticated during 1986 into Indiana and calculating the retaliatory tax based on an . . . domicile would result in no retaliatory tax being due.

. . . application for redomestication was not approved by the Department of Insurance until which is probably the reason the Department originally recommended the retaliatory assessment. In its request for correction, . . . apparently included a copy of a Certificate of Compliance with the laws of . . . dated . . . On this basis, the Department concluded that . . . had redomesticated into I . . . on . . . The Department further concluded that since . . . had redomesticated before the end of 1986, retaliatory tax should be calculated for the entire year using Indiana as the state of domicile, and in a letter to . . . dated . . . the Department informed . . . that it would recommend to the Board that the retaliatory assessment be reduced to zero. In a notice dated . . . , the Board denied the request for correction.

. . . then paid the assessment and filed this claim for refund dated It has submitted a copy of a Certificate of Authority to transact business in . . . dated . . . and a copy of an Administrative Order redomesticating . . . from . . . to . . .

executed by the Commissioner of Insurance on [redacted] has requested a refund of \$217,514.67, which is a proration of the retaliatory tax assessed for the period of September 22 through December 31, 1986, the period of 1986 that [redacted] was no longer domiciled in

Issue

How should retaliatory tax be calculated when a company redomesticates during the tax year?

Discussion

Initially we note that the Department was apparently confused as to the date of redomestication, the Department having used as that date the date appearing on the Certificate of Compliance it received. This certificate is a statement that [redacted] had complied with the applicable laws of [redacted]. This certificate does not appear to relate to the state of domicile. The Administrative Order dated [redacted] however, does specifically order redomestication. Further, the order itself refers to an earlier Certificate of Authority, revoking it and ordering another Certificate of Authority be issued showing [redacted] as an [redacted] domestic insurer. We therefore conclude that the Administrative Order established the official date of domicile in [redacted] as [redacted].

There are two basic methods which can be used to calculate the retaliatory tax when a non-California insurer is domiciled in two different states in a single tax year: 1) prorate the retaliatory tax based on the actual period domiciled in each state; or 2) choose one of the states as the retaliatory tax domiciliary state (e.g., the domicile as of the end of the year, the domicile as of the beginning of the year, or the domicile resulting in the higher retaliatory tax burden).

The Department of Insurance recommends that [redacted] be granted a refund of all retaliatory tax it paid for 1986 on the grounds that [redacted] was an [redacted] domiciliary on [redacted]. The Department refers to language in California Constitution Article XIII, section 28(b), that the gross premiums tax is an annual tax and to language in section 28(f)(3) that for purposes of the retaliatory tax the domicile of an alien insurer is the state in which its principal place of business is located. The Department also refers to Attorney General's Opinion 14-77 (38 Ops.Atty.Genl. 183, 5/17/60) which states that the assessment duties of the Board with respect to the retaliatory tax are not substantially different than with respect to the gross premiums tax. Based on these

authorities the Department believes the retaliatory tax should be assessed based on the insurer's domicile as of December 31st of each year.

The Department also notes the difficulty in prorating or allocating based on time domiciled in each state. The Department is particularly concerned about mergers, acquisitions, assumptions, liquidations etc. These are far more common than moves such as . The Department apparently considers the accounting and auditing problems involved in this approach as virtually insurmountable.

The retaliatory tax provisions in the Constitution (Art. XIII, § 28(f)(3)) and in the statutes (Rev. & Tax. Code §§ 12281-90) do not specifically resolve this issue. The principal purpose of the retaliatory tax is to promote interstate business of domestic insurers by deterring other states from imposing discriminatory or excessive taxes. (Western & Southern Life Ins. Co. v. State Bd. of Equalization (1981) 451 U.S. 648, 668.) In the present case, it appears that the retaliatory tax would most closely accomplish its purpose if Hawaii, perhaps pursuant to persuasion by insurance companies such as had lowered its tax rate. Failing that, perhaps the next most desirable result would be for insurance companies to redomesticate from Hawaii to a state not imposing a tax on California insurers higher than the tax imposed by California.

Since moved from Hawaii before the end of the tax year and the retaliatory tax ostensibly accomplished its secondary purpose, we believe that should get the benefit of that move and not be required to pay a retaliatory tax as if it had been a Hawaiian domiciliary for the entire year. Similarly, since was a Hawaiian domiciliary for part of the year, it is logical that it not fully escape a retaliatory tax by virtue of its domicile in a state with a higher tax than California. We are not persuaded by the Department's legal arguments otherwise. We find, however, the Department's practical arguments regarding the administrative burden of allocating or prorating based on the period domiciled in each state to be highly persuasive.

The Department also notes that it had recommended, and the Board issued, a retaliatory tax assessment to Insurance Company for 1985 when it redomesticated to North Carolina from California on December 31, 1985. The assessment was calculated as if was a domiciliary of North Carolina for the entire year. This, again, is consistent with the purpose of the retaliatory, that is, to dissuade insurers from moving to states with higher taxes. Of course, the

the purpose of the retaliatory, that is, to dissuade insurers from moving to states with higher taxes. Of course, the case does not stand for the proposition, implied by the Department, that the Board necessarily agreed with the assessment. The Department recommended the assessment and the Board complied with its duty to issue the assessment. Since [redacted] did not object, the Board did not consider the merits of the assessment.

Based on the Department's concerns and the lack of clear authority otherwise, I believe it is appropriate to assess the retaliatory tax based on an insurer's domicile at the end of the tax year. This does not detract from, and probably increases, the efficacy of the retaliatory tax in accomplishing its (secondary) purpose. If an insurer is contemplating redomesticating to a state with a higher tax rate, that insurer must take into account that it will be assessed California's retaliatory tax for the entire year of its redomestication. If an insurer is contemplating redomesticating to a state with a lower tax, it may be encouraged to do so since it will get the benefit of a smaller California retaliatory tax for the entire year of its redomestication.

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